FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 29 1947
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

In the Matter of
PITTSBURGH RAILWAYS COMPANY, Debtor.

NO. 1178

PHILADELPHIA COMPANY, Petitioner,
v.
JULES GUGGENHEIM, et al.

NO. 1179

PHILADELPHIA COMPANY, Petitioner,
v.
JULES GUGGENHEIM, et al.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF.

THOMAS J. MUNSCH, JR.,
C. ELMER BOWN,
PHILIP A. FLEGER,
Attorneys for Petitioner.

435 Sixth Avenue,
Pittsburgh, Pennsylvania.

SMITH BROS. CO. INC., LAW PRINTERS, 434-436 BOULEVARD OF ALLIES, PITTSBURGH, PA.

SUBJECT INDEX

	PAGE
Petition for Writs of Certiorari	1
Statement of Case	2
Jurisdiction	8
Question Presented	8
Reasons for Granting the Writs	9
Conclusion	13
Brief in Support of Petition	15
Opinions Below	15
Jurisdiction	15
Statement of the Case	15
Specification of Error	16
Argument	16
Summary	16
The Identity of Persons Who Would Profit By Subordination Should be Investigated	17
Counter-Equities Against the Persons Who Would Profit By Subordination Should Be Investigated	19
a. Time of Acquisition of Claims	20
b. Notice of Laches and Estoppel	21
c. Cost of Acquisition	26
The Authorities Relied Upon By the Circuit Court Are Not In Point	30

TABLE OF AUTHORITIES

CASES: PAGE

American Brake Shoe & Foundry Co. v. Interborough R. Transit Co., 112 F. 2d 669 (2 Cir., 1940) 24

American United Mut. Life Ins. Co. v. City of Avon Park, 311 U.S. 138, 61 S. Ct. 157 (1940) 29

re Associated Gas & Electric Co., 149 F. 2d 996 (2d Cir., 1945) 30

Belden v. Burke, 147 N.Y. 542, 42 N.E. 261 (1895) 23

Continental Trust Co. v. Toledo, St. L. & K. C. R. Co., 82 Fed. 642 (Circ. Ct. N.D. Ohio; 1897) 24

re Deep Rock Oil Corp., 113 F. 2d 266 (10 Cir., 1940) 31

re Deep Rock Oil Corp., 117 F. 2d 615 (10 Cir., 1941) 30, 31

DeWeese v. Reinhard, 165 U.S. 386, 17 S. Ct. 340 (1897) 24

Elias v. Clarke, 143 F. 2d 640 (2d Cir., 1944) 30

Erie Railroad v. Tompkins, 304 U.S. 64, 58 S. Ct. 817 (1938) 25

J. S. Farlee Co. v. Springfield South Main Realty Co., 86 F. 2d 931 (1 Cir., 1936) 28

Godfrey v. Powell, 150 F. 2d 486 (5 Cir., 1945) ..12, 23

Graham v. LaCrosse & M. R. R. Co., 102 U.S. 148, 26 L. Ed. 106 (1880) 24

Guaranty Trust Co. of New York v. Chicago M. & St. P. R. Co., 15 F. 2d 434 (N.D. Ill., 1926) ... 28

CASES: PAGE

Hawes v. Oakland, 104 U.S. 450, 26 L. Ed. 827 (1882) 25

Jencks v. Quidnick Co., 135 U.S. 457, 10 S. Ct. 655 (1890) 13, 27

Lorraine Castle Apartments Bldg. Corporation, Inc., 149 F. 2d 55 (7 Cir., 1945) 30

re McEwen's Laundry, 90 F. 2d 872 (6 Cir., 1937) 28

re Midland United Co., 58 F. Supp. 667, 681 (D.C. Del. 1944) 24

Mississippi & Missouri Railroad Co. v. Cromwell, 91 U.S. 643, 23 L. Ed. 367 (1876) 13, 28

re Missouri Pacific R. Co., 64 F. Supp. 64 (E.D. Mo., Dec. 21, 1945) 12, 23

Palmer v. Bankers' Trust Co., 12 F. 2d 747 (8 Cir., 1926) 28

re Pittsburgh Railways Company, 155 F. 2d 477 (3 Cir., 1946) 4

Standard Gas & Electric Co. v. Deep Rock Oil Corp., 117 F. 2d 615 (10 Cir., 1941) 30

Taylor v. Standard Gas & Electric Co., 306 U.S. 307, 59 S. Ct. 543 (1939) 2, 9, 31

STATUTES

PAGE

Bankruptcy Act, Chapter X:
Sect. 24(c), 11 U.S.C.A. 47 8
Sect. 121, 11 U.S.C.A. 521..... 8
Sect. 166, 11 U.S.C.A. 566..... 20
Sect. 167, 11 U.S.C.A. 567..... 19
Sect. 198, 11 U.S.C.A. 598..... 18
Sect. 203, 11 U.S.C.A. 603..... 20
Sect. 210, 11 U.S.C.A. 610..... 20
Sect. 211, 11 U.S.C.A. 611..... 20
Sect. 212, 11 U.S.C.A. 612..... 20

Judicial Code, Sec. 240(a), 28 U.S.C.A. 347..... 8

Pennsylvania Statutes:
Act of April 18, 1945, P. L. 253; 12 P.S. 1321-1323 25

MISCELLANEOUS

The Conflict of Equities Under the "Deep Rock" Doctrine, (Sprecher) 43 Columbia Law Review, 336 .....21, 22

Pomeroy's Equity Jurisprudence, 5th Ed., 1941—Vol 2, pp. 601-602..... 21

Rule 23 (b), Federal Rules of Civil Procedure..... 25

General Order in Bankruptcy No. 21(3)..... 29

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

In the Matter of
PITTSBURGH RAILWAYS COMPANY, Debtor.

NO. .....

PHILADELPHIA COMPANY, Petitioner,
v.
JULES GUGGENHEIM, et al.

NO. .....

PHILADELPHIA COMPANY, Petitioner,
v.
JULES GUGGENHEIM, et al.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

The petitioner, Philadelphia Company, respectfully petitions this Honorable Court for writs of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

STATEMENT OF CASE.

In the reorganization proceedings of Pittsburgh Railways Company, in the District Court of the United States for the Western District of Pennsylvania, the Court directed, by Order dated November 7, 1945, an investigation for the purpose of determining whether the claims of Philadelphia Company, the parent and a creditor of the debtor, should be limited or subordinated under the so-called "Deep Rock" rule of *Taylor v. Standard Gas & Electric Company,* 306 U. S. 307, 59 S. Ct. 543 (1939). No appeal having been taken from the order of November 7, the Trustee's investigation has proceeded, but has not yet been completed.

The present case arises out of the efforts of Philadelphia Company to have the scope of the investigation broadened so as to determine the identity of the persons who would profit by the subordination of its claims and to determine whether there are any counter-equities against such persons. The facts relating to Philadelphia Company's efforts to broaden the scope of the investigation can best be understood in the light of the facts leading to the investigation of Philadelphia Company.

Proceedings Leading to Investigation of Philadelphia Company.

Pittsburgh Railways Company filed a voluntary petition for reorganization on May 10, 1938. A question concerning the status of its underlier or lessor companies having arisen, the City of Pittsburgh filed a petition, on October 23, 1942, seeking to have the Court assume jurisdiction over the underliers (R. 34 a). The case was referred to a Special Master, and the City's

evidence, covering in detail the history of the companies, was completed on March 17, 1943 (R. 34 a).

In the following month, April, 1943, Jules Guggenheim, *et al.*, a group of persons from New York and vicinity, began to acquire securities of Pittsburgh Railways Company and its underliers (R. 34 a). The purchase price of their securities was comparatively low, in contrast with the higher market prices of such securities which later materialized (R. 39 a). All of the securities held by this group were acquired between April, 1943 and November, 1944 (R. 34 a; 43 a-49 a). It must be noted, however, that Jules Guggenheim et al. are only a small portion of the Debtor's security-holders. The Court below, as we shall see, has declined to cause an investigation to ascertain whether similar facts are true with respect to other security-holders.

In December, 1944, Jules Guggenheim *et al.* filed a petition praying for the amendment of the Trustee's plan of reorganization, so as to subordinate the claims of Philadelphia Company (R. 35 a). The averments of the petition were to a large extent copied from the petition and brief of the City of Pittsburgh in the matter of the underlier companies, which was then still pending before the Special Master (R. 35 a).

In January, 1945, the Special Master filed his report, recommending the dismissal of the City's petition. After a full and complete review of the facts, the Master concluded, *inter alia,* that no wrongful acts appeared to have been committed by Philadelphia Company (R. 35 a).[1] The same conclusion was reached by the District Court.

---

[1] Although the Circuit Court found, on appeal, that the Master's report was "full and complete and most

In June, 1945, the District Court granted a hearing on the petition of Guggenheim *et al.*, filed December 22, 1944, and notices were sent to all parties (R. 36 a). Shortly before the hearing, Guggenheim *et al.*, influenced, one may infer, by the fact that the Master had found that no mismanagement existed, amended the prayer of their petition so as to seek, not the outright subordination of Philadelphia Company as originally prayed for (R. 35 a), but rather an investigation by the Trustee to determine whether there existed grounds for such subordination (R. 36 a).

On November 7, 1945, after a hearing, the District Court granted the prayer of the Guggenheim petition (R. 14 a-19 a; 63 F. Supp. 7), and directed the Trustee of the debtor to conduct an examination under Sections 21a and 167 of the Bankruptcy Act "* * * for the purpose of inquiring into the matters described in the aforesaid petition of Jules Guggenheim *et al.*, as well as any other matters relating to possible claims or causes of action available to the estate against Philadelphia Company or any other party, and other grounds for the equitable limitation or subordination of claims filed by Philadelphia Company in this proceeding * * *." (R. 20 a).

---

carefully done", it filed an opinion on May 7, 1946 reversing the District Court's decision, which had followed the Master's recommendation that the City's petition be dismissed. (In re Pittsburgh Rys. Co., 155 F. 2d 477). Certiorari was denied by this Court on October 14, 1946, ... U.S. .... 67 S. Ct. 89, 90. Nothing in the Circuit Court's opinion, however, is in derogation of the conclusion of the Master and the District Court that no wrongful acts appeared to have been committed by Philadelphia Company.

No appeal was taken from this order, and the Trustee's investigation has proceeded.

Efforts of Philadelphia Company to Broaden the Investigation.

Philadelphia Company moved promptly (on November 21, 1945, two weeks after the examination was ordered), to serve notice of a motion to enlarge the scope of the investigation to the following ends (R. 21 a, 22 a):

> "1. So as to cause the investigation to apply not only to Philadelphia Company, but to all holders of bonds, notes, securities or liabilities of the debtor, and
>
> "2. So as to cause the investigation to apply, not only to claims actually filed against the debtor, but to all notes, bonds, securities or liabilities of the debtor, whether or not claims have actually been filed thereon."

On January 21, 1946 the District Court refused the aforesaid motion (R. 29 a) and filed an opinion stating in part (R. 29 a; In re Pittsburgh Rys. Co., 64 F. Supp. 231):

> "If the investigation sought for will be of value hereafter, the Court can make such an order at any time upon presentation of proper facts in support thereof."

Philadelphia Company (although intending to file a petition stating the facts more fully), filed an appeal from the Order of January 21 and this appeal was before the Circuit Court at No. 9129, the District Court having extended the time for filing the record on appeal (R. 31 a). As the District Court was advised (R. 38 a)

the appeal at No. 9129 was taken merely as a cautionary measure to preserve Philadelphia Company's rights in the event that it should be contended that the Order of January 21, 1946 was *res adjudicata* with respect to a later petition on the same subject matter.

Such a later petition was filed on March 6, 1946 and is printed at pages 32(a) to 51(a) of the Record. In support of an enlargement of the investigation it sets forth among other things the following facts:

1. A majority of the public holders of bonds of the debtor have not filed claims in this proceeding. Such bondholders, however, may be entitled to participate in the benefits of the application of the "Deep Rock" rule by virtue of claims filed by indenture trustees, which do not disclose the identity of the bondholders on whose behalf they are filed.
2. There has been a large amount of trading in the publicly held securities of the debtor and a large number of securities have been purchased since the inception of the reorganization proceedings.
3. The extent and nature of the trading in securities of the debtor indicates that many of the present holders of obligations of the debtor are not bona fide purchasers for value but are charged with notice of all defenses against their securities, and are charged with notice of the acts which have been pointed to as a basis for the subordination of the claims of Philadelphia Company.
4. The trend of market prices of securities of the debtor indicates that many securityholders

> have acquired their securities at relatively low prices, that such securities have advanced to relatively high prices so that such security-holders are already in a position to make a large profit. This profit will be much larger and may be so large as to amount to an unjust enrichment if such securities are granted priority to the securities held by Philadelphia Company.

Not knowing the identity of most of the public securityholders, Philadelphia Company was unable to make more specific charges of fraud or counter-equities.

The prayer of the petition was the same as that of the motion filed November 21, 1945, previously described (*Supra*, p. 5). Notice of the petition was served on all parties in interest (R. 53 a).

At the hearing on its petition, Philadelphia Company offered to substantiate by evidence the facts averred therein (R. 79 a), but the Court chose not to receive such evidence (R. 68 a, 76 a) and dismissed the petition, by order dated May 1, 1946 (R. 81 a). It is the appeal from this order (No. 9163 in the Circuit Court) which was pressed by Philadelphia Company in the Circuit Court and which was there denied.

JURISDICTION.

The orders of the Circuit Court of Appeals were entered on December 31, 1946 (R. 85, 91, 92).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U.S.C.A. 347). Section 240(a) is rendered applicable to appeals in bankruptcy reorganization proceedings by Section 121 of Chapter X (11 U.S.C.A. 521) which in turn makes reference to the Bankruptcy Act. (Sect. 24(c); 11 U.S.C.A. 47).

QUESTION PRESENTED.

In a corporate reorganization proceeding, where the Court has ordered an investigation to determine whether there are grounds for the equitable limitation or subordination of the claims of the parent corporation of the debtor, does the Court err when it refuses to broaden the scope of the investigation so as to determine (a) the identity of the persons who would profit by such limitation or subordination, and (b) whether there are counter-equities against such persons which should be taken into consideration in determining whether such persons are equitably entitled to profit by the limitation or subordination of the claims of the parent, and in determining whether such persons themselves might be subject to equitable limitation or subordination?

REASONS FOR GRANTING THE WRITS.

1. The Decision of the Circuit Court of Appeals Involves Important Questions of Law which have not been, but should be, Decided by this Court.

The decision of the Circuit Court deals with a question of great importance in the application of the so-called "Deep Rock" rule of *Taylor v. Standard Gas & Electric Company*, 306 U.S. 307, 59 S. Ct. 543 (1939). Pursuant to the "Deep Rock" rule, in corporate reorganization proceedings, the claims of a corporate parent may, in certain circumstances, be subordinated to the claims of public securityholders against the estate of a subsidiary. The importance of these cases stems from the fact that the amounts involved are large. Millions of dollars are involved in the present case. Hundreds of millions are involved in other cases of a similar nature.

With these huge amounts at stake, the decision of the Circuit Court denies to a corporate parent against whom charges of mismanagement are asserted, the right adequately to prepare a defense to the charges made against it. The corporate parent is denied the opportunity even to ascertain the identity of its adversaries, the securityholders who would benefit by the subordination of the parent's claims. The parent is unable, therefore, to take the first step towards preparing a defense or to ascertain whether there are counter-equities or counterclaims against these adversaries. It is compelled to stand by helpless to assert such defenses as further investigation might disclose, while the other securityholders proceed, with the aid of the Court and

at the expense of the estate, to try to build up a case against it.

The case derives further importance from the fact that the damage, once done to the corporate parent, is irreparable. It will be too late to develop the defenses of counter-equities, after a hearing has been had on the question of subordination.

Furthermore, the decision of the Circuit Court has an important bearing upon the law of evidence in corporate reorganization proceedings. The Circuit Court excludes certain evidence from the type of evidence which the reorganization trustee is obliged to investigate. The evidence thus excluded from the investigation relates to, (a) the *time of purchase* of securities by those who would benefit from the subordination of the parent, together with the related question of whether such securityholder bought into the reorganization proceedings with *notice* of the acts complained of, and (b) the *cost* to the security-holder of the securities which he purchased, together with the related question of the *profit* which he will derive if he is granted the privilege of subordination. The corporate defendant in a "Deep Rock" case is thus denied any practical means of showing, what may well be the fact, that the majority of the debtor's securities are in the hands of speculators who recently bought them with full knowledge of the facts, and for the purpose of stirring up litigation. He is denied the means of showing that these securities were purchased for a trivial price, a price so low that the effect of allowing the subordination of the parent would be to skyrocket the speculator's profit to approxi-

mately 1200% on their investment. Even more shocking facts than these may be disclosed by investigation.

The question whether a corporation, against whom a "Deep Rock" claim is asserted, is entitled to know the identity of its adversaries, or the time when they acquired their securities, has never been passed upon by this Court. Because of the importance of the questions involved, we submit that these questions should be authoritatively answered.

The question whether the cost of securities to their present holders is relevant to the application of the "Deep Rock" rule, has never been passed upon specifically by this Court in a "Deep Rock" case. As we shall point out, however, (infra, p. 13) the decisions of this Court in other cases demonstrate that this aspect of the question should be answered contrary to the decision of the Court below.

2. The Decision of the Circuit Court is in Conflict with Decisions in other Circuits insofar as it Excludes from the Scope of the Trustee's Investigation Evidence of a Type which has been Treated as Relevant in Other Circuits.

The Circuit Court declines to have the Trustee investigate whether securities, on whose behalf a "Deep Rock" claim is asserted, have been purchased at a recent date and with knowledge of the acts of which complaint is made. In other circuits, however, courts have made reference to these very same circumstances in disposing of "Deep Rock" claims.

In *Godfrey v. Powell,* 150 F. 2d 486 (5 Cir., 1945) in disposing of the contention of certain appellants that bonds of other parties should be subordinated, the Fifth Circuit took into consideration the fact that appellants had bought into the proceeding at a recent date. It said (150 F. 2d 489-490):

> "We put to one side the *untenable position of the active appellants in having bought into a situation for the purpose of attacking transactions which had taken place before their purchase,* to consider the matter from the standpoint alone of the other bond holders." (italics supplied).

Similar evidence was taken into consideration in the corporate reorganization proceedings of *Missouri Pacific R. Co.* (64 F. Supp. 64; E.D. Mo., 1945). The Court there dealt, among other things, with the contention of one Comstock that certain claims should be subordinated to his own. In dismissing his contention, it took into consideration the time when Comstock became a securityholder (64 F. Supp. at 77-78).

> "*The objector Comstock purchased the securities which give him entree to this proceeding as a speculation in the latter part of 1942 and in the early part of 1943,* and he did not become a party until September 30, 1943. No facts have been shown that have not been available to all for many years; and Comstock's being a newcomer does not relieve him from the defense of laches. The bonds that he holds are subject to all of the infirmities which existed at the time he bought them. * * * Comstock cannot contend he is in the position of a person from whom the facts have been concealed. Rather, he has taken facts apparent to all and only at the twelfth hour has come forward." (italics supplied)

3. The Circuit Court's Decision is in Conflict with the Decisions of this Court, in that it Excludes from the Scope of the Trustee's Investigation Evidence which, under the Decisions of this Court, is Relevant.

The Circuit Court holds that a reorganization trustee, in making an investigation as to the application of the "Deep Rock" rule, may ignore the question of the cost of acquisition by public security-holders, and the extent of the profit which would inure to such security-holders if the remedy of subordination were granted. There are decisions in this Court, on the other hand, which clearly hold that a court of equity, in determining whether equitable relief should be granted, will give consideration to the extent of the profit which would inure to the plaintiff by virtue of the relief for which he prays. *Jencks v. Quidnick Co.*, 135 U. S. 457, 10 S. Ct. 655 (1890). *Mississippi & Missouri Railroad Co. v. Cromwell*, 91 U. S. 643, 23 L. Ed. 367, 368 (1876).

CONCLUSION.

For the foregoing reasons it is respectfully submitted that writs of certiorari should issue to the Circuit Court of Appeals for the Third Circuit.

.....

THOMAS J. MUNSCH, JR.

.....

C. ELMER BOWN

.....

PHILIP A. FLEGER

Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

OPINIONS BELOW.

The opinion of the District Court (McVicar, J.) on the Motion filed November 21, 1945 (No. 9125 in the Circuit Court of Appeals) is reported at 64 F. Supp. 231, and appears at pages 27 a to 29 a of the Record.

The opinion of the District Court (McVicar, J.) on the Petition filed March 6, 1946 (No. 9163 in the Circuit Court of Appeals) is not yet reported, but appears at pages 77 a to 81 a of the Record.

The opinion of the Circuit Court of Appeals for the Third Circuit (McLaughlin, J.) is not yet reported, but appears at pages 85 to 90 of the Record.

JURISDICTION.

See Petition for Writs of Certiorari, page 8, *supra*.

STATEMENT OF THE CASE.

See Petition for Writs of Certiorari, page 2, *supra*.

SPECIFICATION OF ERROR.

The Circuit Court of Appeals erred in excluding from the proper scope of the reorganization trustee's investigation into possible grounds for the equitable limitation or subordination of claims of the parent of the debtor, (a) the identity of the persons who would profit by such limitation or subordination, and (b) whether there are counter-equities against such persons.

ARGUMENT.

Summary.

Where an investigation is ordered to determine whether the claims of a parent should be subordinated, it should develop *all* of the facts which have a bearing on that question. Facts relevant to the defenses of the parent should be developed along with those which may be relied upon as a basis for the parent's subordination.

First and most important, the identity of the persons who would profit by the subordination of the parent should be ascertained. (*infra,* p. 17).

Furthermore, investigation should be made into possible counter-equities against those who would profit by subordination. The following questions, among possible others, should be answered:

When did such persons acquire their securities? (*infra,* p. 20).

Have they purchased with notice of the acts of which they complain? Have they purchased since the inception of the reorganization? (*infra,* p. 21).

What was the cost to them of their securities? (*infra*, p. 26).

How much profit will inure to them if the remedy of subordination is granted? Will their profit be unreasonably high? (*infra*, p. 26).

Any investigation which ignores these questions is necessarily incomplete, one-sided, and unfair in its result.

1. The Identity of Persons Who Would Profit by Subordination Should Be Investigated.

The claims of a parent company cannot be subordinated in the abstract. If subordinated at all, they must be subordinated to the obligations of someone else. And when the court, in the exercise of its equitable powers, comes to consider the question whether the claims of a parent company should be subordinated, it must necessarily determine to whom they will be subordinated. In other words, it must determine who will be parties to benefit by its action.

In the present case, however, the ownership of a majority of the publicly-held bonds of the Debtor is unknown (R. 33 a, 34 a). This lack of knowledge of the identity of parties arises from the fact that certain public securityholders may participate in distribution by virtue of claims filed by their indenture trustees. They may do this by virtue of the Order of the reorganization court dated July 22, 1938, Section 14(a) of which provides in part:

"Holders of bonds and other securities issued under indentures shall not be required to file separate proofs of claim in order to preserve their rights on

distribution as aforesaid, but the proofs of claim filed by the respective indenture trustees shall be deemed filed on behalf of the respective holders thereof insofar as preserving their rights on distribution are concerned."

A similar privilege is granted by Section 198 of Chapter X, 11 U.S.C.A. 598, which provides:

"An indenture trustee may file claims for all holders, known or unknown, of securities issued pursuant to the instrument under which he is trustee, who have not filed claims: Provided, however, that in computing the majority necessary for the acceptance of the plan only the claims filed by the holders thereof, and allowed, shall be included."

It is important to analyze the nature of the rights granted to the indenture trustees by the foregoing provisions. The right granted is merely the right to file a claim. It is a right merely to assert the contractual rights of the bondholder to *equality* of treatment with other bondholders. It is not the right to secure the privilege of preferred treatment for a bondholder by virtue of a claim for mismanagement based on a tort committed by another bondholder. When, therefore, it is asserted that the claim of the indenture trustee goes beyond asserting the right to equality of treatment, a court of equity, before it lends its aid, should require the beneficiaries of the claim to come out into the open and reveal their identity.

It is not inequitable to require this information from persons to whom a court of equity is asked to give a preferred standing. Equitable though it may be to permit them to remain anonymous while receiving equality

of treatment in distribution (and section 198 does no more than this), it is not equitable to permit a preferred standing to be attributed to them while their identity remains undisclosed. A court of equity should refuse to exercise its extraordinary powers on behalf of one who refuses to come out into the open and be identified. Equity acts in personam.

Furthermore, section 197 of Chapter X (11 U.S.C.A. 567) calls for an investigation into the "liabilities" of the debtor. This should refer not merely to some, but to *all,* liabilities, whether owed to a parent corporation or to others.

2. Counter-Equities Against the Persons Who Would Profit by Subordination Should Be Investigated.

An investigation should be undertaken if the facts to be investigated have some probative value and are proper items for consideration by the court. It is not necessary that the facts sought to be ascertained be of themselves sufficient to bar the asserted preferred standing of public security holders. Evidence, to be admissible, need not be completely determinative of the issue. It need merely carry some weight.

Conversely, investigation should be denied only if the matters to be investigated could not possibly be relevant under any conceivable fact situation that investigation might disclose.

In urging, therefore, that the counter-equities of cost, notice, and time of acquisition be investigated, we do not deem it our burden to prove that this fact or that one, or even the whole group of facts which we shall discuss, would, if true, deny a preferred status to those for whom a preference is claimed. It is enough to prove

that these facts would have some effect upon the conscience of the chancellor and therefore should be laid before him.

We turn, then, to the type of counter-equity which should be investigated, but which the court below has refused to investigate. In analyzing these factors, we make no claim that our list of them is all-inclusive. We contend merely that these are some of the facts which must be taken into account if an investigation of the "Deep Rock" question is to be complete:

(a) The time of acquisition of claims (*infra*, p. 20).

(b) Notice, laches, and estoppel (*infra*, p. 21).

(c) The cost of acquisition of claims (*infra*, p. 26).

(a) *Time of Acquisition of Claims*

Numerous sections of Chapter X. make relevant the question of the time when securities were acquired. Section 166, 11 U.S.C.A. 566, provides that the court may refuse to permit inspection of schedules of creditors, etc., "by any creditor or stockholder who acquired his claim or stock within three months preceding the filing of the petition under this chapter or during the pendency of the proceeding."

Section 203, 11 U.S.C.A. 603, provides that the refusal to accept a plan may be disregarded where it is not in good faith "in the light of or irrespective of the time of acquisition" of such claim.

Sections 210 and 211, 11 U.S.C.A. 610, 611, provide that said information as to the time of the acquisition of claims be filed by certain attorneys and committees. Section 212, 11 U.S.C.A. 612, provides for the limitation to the actual consideration paid therefor as to "any

claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter." Obviously, the application of this section requires a determination of the time of acquisition of the security in question.

In "The Conflict of Equities Under the 'Deep Rock' Doctrine", 43 Columbia Law Review, 336, 352, the author, Robert A. Sprecher, states:

> "All claims or interests purchased subsequent to the commencement of bankruptcy proceedings, or prior thereto with knowledge of their imminence, should be subject to special scrutiny by the bankruptcy court, regardless of whether the claims or interests are held by fiduciaries or non-fiduciaries and regardless of whether speculation is actually proved or not."

(b) *Notice, Laches and Estoppel*

Time of purchase is related to the further equitable defenses of notice, laches and estoppel. We submit that one who buys into litigation with his eyes open, does not have the same standing before a court of equity as does one who is imposed upon against his will; and that it will be relevant, therefore, to ascertain whether the parties who would profit by subordination purchased their securities with notice of the acts of mismanagement on which such subordination is sought to be predicated.

In Pomeroy's Equity Jurisprudence (5th Ed., 1941) it is stated (Vol. 2, pp. 601-602) that:

> "When a person is acquiring rights with respect to any subject-matter, the fact whether he is so acting with or without notice of the interests or claims of others in or upon the same subject-matter is

regarded throughout the whole range of equity jurisprudence as a most material circumstance in determining the extent and even the existence of the rights which he actually acquires."

In "The Conflict of Equities under the 'Deep Rock' Doctrine", 43 Columbia Law Review 336, *supra,* the author, in dealing with the situation where grounds exist for the subordination of a parent corporation's claim, concludes (p. 352):

"If it is shown that all claims were purchased after the institution of bankruptcy proceedings, the parent's claim should not be subordinated. If some, but not all, of the claims were purchased after bankruptcy, the parent's claim should be subordinated, but all claims purchased after bankruptcy at a price below that set by the court, or in the absence of such a price, without prior consent of the court, should also be subordinated.

"Observance of these principles by bankruptcy courts would tend to protect innocent claimants and to discourage speculation without appreciably diminishing the bona fide market for negotiable securities. At the same time the parent's claim, and the creditors or stockholders who benefit by allowance of that claim, would be placed in their proper relation to other claimants of the debtor's estate."

There are cases which clearly hold that time of acquisition of securities and notice of acts complained of, are relevant to a determination of a security-holder's rights. Brief reference will be made to these authorities, none of which are distinguished in the Circuit Court's opinion.

In *Godfrey v. Powell,* 150 F. 2d 486 (5 Cir., 1945), the Fifth Circuit, in denying an asserted right to have other claims subordinated, said (pp. 489-490):

> "We put to one side the *untenable position of the active appellants in having bought into a situation for the purpose of attacking transactions which had taken place before their purchase,* to consider the matter from the standpoint alone of the other bond holders." (Italics supplied)

In re Missouri Pacific R. Co., 64 F. Supp. 64 (E.D. Mo., 1945), the court denied the asserted right of one Comstock to have other claims subordinated to his own. It relied upon the fact that Comstock was a recent purchaser, saying (p. 77):

> "The objector Comstock purchased the securities which gave him entree to this proceeding as a speculation in the latter part of 1942 and in the early part of 1943, and he did not become a party until September 30, 1943."

In *Belden v. Burke,* 147 N.Y. 542, 42 N.E. 261 (1895), a holder of railroad bonds filed a bill in equity against certain corporate directors and other parties to compel an accounting for the diversion of the proceeds of the bonds. Because the plaintiff had purchased his bonds with notice that their proceeds had been put to the use of which he later complained, the bill was dismissed. The Court said (147 N.Y. 556):

> "Having acquired the bonds with knowledge of all the facts, he must, in equity, be deemed to have acted upon and acquiesced in the condition of the security as he found it."

Also in point, to the same effect, are *American Brake Shoe & Foundry Co. v. Interborough R. Transit Co.*, 112 F. 2d 669 (2 Cir., 1940), *Continental Trust Co. v. Toledo, St. L.&K. C.R. Co.*, 82 Fed. 642 (N.D. Ohio, 1897), *Graham v. LaCrosse & M. R. R. Co.*, 102 U.S. 148, 26 L. Ed. 106 (1880), and *De Weese v. Reinhard*, 165 U.S. 386, 17 S. Ct. 340 (1897).

In the case of *re Midland United Co.*, 58 F. Supp. 667, 681, Judge Biggs of the Third Circuit, sitting in the District Court and considering a plan of reorganization, said, with respect to certain objectors to the plan (58 F. Supp. at 681):

> "Many of the objectors are shown to be rather recent purchasers of Utilities debentures and prior lien stock. This of course does not deprive them of the right to be heard in respect to a plan which will dispose of the interests acquired by them and their objections require full consideration. *The fact that the objectors acquired their securities and stock with what must be deemed to be knowledge of existing litigation is, however, a fact which the court may weigh in determining their purpose.*" (Italics supplied)

This case is distinguished by the Circuit Court (R. 90) on the ground that a plan of reorganization was before the Court in the Midland United case. But the Circuit Court overlooks the fact that the purpose of expanding the investigation in the present case is for the sole purpose of making the information to be elicited available to the court when a plan of reorganization ultimately comes before it. If the facts will be relevant when a plan is before the court, they should be investi-

gated now, so that they may be presented to the court in connection with a plan.

Furthermore, the Circuit Court overlooks the analogy of stockholders' suits. If the Pittsburgh Railways were not in bankruptcy, the claims of stockholder-claimants would be asserted in stockholders' suits. The first requirement in a stockholder's suit is that the plaintiff must have owned his shares at the time of the alleged injury of which he complains. This rule has been codified in Rule 23(b) of the Federal Rules of Civil Procedure, which, in turn, stated the rule of *Hawes v. Oakland,* 104 U.S. 450, 26 L. Ed. 827 (1882).

The principle of Rule 23(b) is also the law of Pennsylvania, pursuant to the Act of April 18, 1945, P. L. 253; 12 P.S. 1321. This Act provides that in stockholders' suits:

> "* * * the plaintiff or plaintiffs must aver and it must be made to appear, that the plaintiff or each plaintiff was a stockholder at the time of the transaction of which he complains, or that his stock devolved upon him by operation of law from a person who was a stockholder at such time."

The Circuit Court's decision places a stockholder in a bankruptcy proceeding in a much more favorable position than he would occupy if he were asserting his rights in a stockholder's suit. Such a result, we submit, is contrary to public policy. The rights of the parties should not be permitted to vary according as suit is brought in one court or another or in one form of action or another. *Erie Railroad v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817 (1938).

(c) *Cost of Acquisition*

A court of equity will always take into consideration the question of the profit accruing to one who seeks its aid. If an unconscionable profit will result, aid will be refused. It follows, therefore, that in determining whether the claims of a parent company should be subordinated, the court should take into consideration the actual profit which will inure to those who would benefit by such subordination. This in turn will make it necessary that the court be advised of the cost of the obligations of the Debtor held by the persons who would profit by the subordination of the parent company. Aside from principles of equity, common sense and good business sense should require that this fact be taken into consideration.

As a practical matter, one who has recently acquired a bond of a debtor in reorganization and who asserts a "Deep Rock" claim thereon, is in a dilemma. Either he must show that the price which he paid amounted to a fair compensation to his seller for the asserted equitable cause of action, or he must admit that he is asking a court of equity to give him something for nothing. To pursue this analysis, it may be noted that the bondholder's rights consist of two parts: (1) His legal right to equality of treatment (which he will receive in any event, whether his "Deep Rock" claim is valid or not) and (2) His asserted equitable right to an increment over and above his legal right, as a result of his preferred standing under the "Deep Rock" rule. Even if it be presumed that the purchaser of the bond paid a fair value for his legal right (Item (1), supra), it may be questioned whether the purchase price in-

cluded any allowance for the equitable right (Item (2), supra), which the purchaser asserts. If his price was extremely low, we may presume that no element of the equitable right was taken into account in the purchase. In such a case, therefore, the purchaser of the bond, when he asserts a "Deep Rock" claim, is asking a court of equity to give him something which he never paid for, and which would result in an unjust enrichment to him, as well as an unjust loss to the seller from whom he bought.

We submit that the foregoing is a practical consideration which courts should not ignore, and that it derives support from the decisions of this Court, which make it clear that the profit accruing to one who would benefit by a decree in equity will be taken into consideration by the court whose aid he seeks.

In *Jencks v. Quidnick Co.*, 135 U.S. 457, 10 S. Ct. 655 (1890) this Court affirmed the dismissal of a bill in equity to establish title to certain shares of stock, where it appeared that an unconscionable profit would have resulted to the plaintiff. It said (135 U.S., at 458):

> "In other words, these complainants are asking the interposition of a court of equity to establish their title to property worth over half a million of dollars obtained by purchase at execution sales for $275. The immense disproportion between the value and the cost shocks the conscience of a chancellor, and forbids the supporting action of a court of equity. Some rights must have suffered, and some wrong must have been done, by such a transaction; and a court of equity properly says that it will not lend its aid to further such an unconscionable speculation."

In the case of *Mississippi and Missouri Railroad Co.* v. *Cromwell,* 91 U.S. 643, 23 L. Ed. 367 (1876) a judgment creditor, having levied execution on certain stock of a railroad company, bought it at public auction. When, however, he sought the aid of a court of equity to compel the railroad to transfer the stock, relief was refused for the reason, among others, that the plaintiff would receive an unconscionable profit on the transaction. Referring to the possible profit to the plaintiff, the court said (91 U.S., at 645):

> "To him [the plaintiff] it will be a windfall, like a prize in a lottery. He paid no adequate consideration to entitle him to claim it as a matter of equity. If the law gives it to him, he should seek his remedy at law. Equity will not lend its aid to any such games of hazard. * * * He comes into court with a very bad grace when he asks to use its extraordinary powers to put him in possession of $30,000 worth of stock for which he paid only $50. The court is not bound to shut its eyes to the evident character of the transaction. It will never lend its aid to carry out an unconscionable bargain, but will leave the party to his remedy at law."

In numerous reorganizations, Courts have taken into account the consideration paid for claims by creditors. *J. S. Farlee Co. v. Springfield South Main Realty Co.,* 86 F. 2d, 931, 936 (1 Cir., 1936). *Palmer v. Bankers' Trust Co.,* 12 F. 2d 747, 754 (8 Cir., 1926). *Guaranty Trust Co. of New York v. Chicago M. & St. P. R. Co.,* 15 F. 2d 434, 443 (N.D. Ill., 1926).

In re McEwen's Laundry, 90 F. 2d 872, 873 (6 Cir., 1937) the Court refused to dismiss a petition that sought, as to claims assigned after the inception of a

reorganization, "that the Court order an accounting be had and determine the consideration paid therefor."

The McEwen case has been cited with approval by this Court which said, in *American United Mut. Life Ins. Co. v. City of Avon Park,* 311 U.S. 138, 146; 61 S. Ct. 157, 162:

> "The requirement of full, unequivocal disclosure; the limitation of the vote to the amount paid for the securities (In re McEwen's Laundry, Inc., 6 Cir., 90 F. 2d 872); * * * indicate the range and type of the power which a court of bankruptcy may exercise in these proceedings."

That the cost of acquisition is a proper item for consideration by the court is further indicated by General Order 21(3) in Bankruptcy, which provides:

> "If a claim has been assigned after the commencement of the proceedings, but before proof of claim has been filed, the proof of claim therefor shall be supported by an affidavit of the owner at the time of the commencement of the proceedings, *setting forth the true consideration for the debt,* what payments have been made thereon, and that it is entirely unsecured, or if secured, the security as is required in proving secured claims." (italics supplied).

Another fault of the Circuit Court's decision is that it loses sight of the distinction, pointed out above (pp. 26-27), between a securityholder's claim in contract on his bond, and his claim in tort for mismanagement. The Third Circuit in this respect fails to draw a distinction which has been observed in the Second Circuit where, under the law of New York, the transfer of a bond does not operate to pass a cause of action for tort unless such

cause of action is specifically assigned. *Elias v. Clarke,* 143 F. 2d 640, 644 (2d Cir. 1944; cert. den. 323 U.S. 778, 65 S.Ct. 191. *Re Associated Gas & Electric Co.,* 149 F. 2d 996, 1008 (2d Cir., 1945; cert. den. 326 U.S. 736, 66 S. Ct. 45).

Since New York is the residence of the persons most actively urging subordination, many of the bonds in the instant case were undoubtedly transferred to their present holders in that State. Since, in such a case, a cause of action for mismanagement would not pass unless it were specifically assigned (Restatement, Conflict of Laws, sects. 349, 350), investigation would probably disclose that the present holders of the bonds are not entitled to assert claims for mismanagement. The same may be true of assignments made in Pennsylvania or in other states. The effect of the instant decision, however, is to foreclose any inquiry into this highly important question.

3. The Authorities Relied Upon by the Circuit Court Are Not in Point.

The Circuit Court rests its decision on *Lorraine Castle Apartments Bldg. Corporation,* 149 F. 2d 55, 7th Cir., 1945, and *Standard Gas & Electric Company v. Deep Rock Oil Corp.,* 117 F. 2d 615, 10th Cir., 1941. Neither of these cases is controlling on the point at issue.

The *Lorraine Castle* case goes no further than to say that a security holder will not ordinarily be limited in his participation to the cost which he paid for his security. The case holds that where a security holder merely seeks *equality* of treatment, the price which he paid for his security is irrelevant. But such a decision is quite different from the instant case in which public

security holders are seeking *priority* in distribution by virtue of the Deep Rock Rule. We submit that, where priority is sought by public security holders (as in the instant case) the counter-equities above referred to are relevant, and the *Lorraine Castle* case decides nothing to the contrary.

The *Standard Gas & Electric* case involved an attempt by Standard Gas to ascertain the cost to public security holders of their securities. The question of identity of security holders or the time of acquisition does not appear to have been in issue. Furthermore, the question of cost was not raised until *after* the question of subordination had been decided by this court. (*Taylor v. Standard Gas and Electric Co.,* 306 U.S. 307, 59 S. Ct. 543, 1939), and after the Circuit Court, on remand of the case, had construed this court's mandate as unqualifiedly commanding the subordination of Standard's claims. (*In re Deep Rock Oil Corporation,* 113 F. 2d 266; 1940). The Court's subsequent decision to deny an inquiry into the cost of claims (117 F. 2d 615; 1941) was therefore based on nothing more than the Court's obligation to abide by what had previously been decided by this Court and to refuse a reopening, for further evidence, of a matter which was *res adjudicata.* Such a decision is not authority in opposition to a prompt and timely request for an investigation such as was made in the instant case.

Respectfully submitted,

THOMAS J. MUNSCH, JR.,
C. ELMER BOWN,
PHILIP A. FLEGER,
Counsel for Philadelphia Company.